

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS – ORDER NO. 2015- _____
DECEMBER ____, 2015

IN RE:)	
Application of Daufuskie Island Utility Company, Inc.)	ORDER APPROVING
For Approval of a New Schedule of Rates and)	RATES
Charges for Water and Sewer Service)	AND CHARGES

I. INTRODUCTION

This matter is before the Public Service Commission of South Carolina (the “Commission”) on the Application of Daufuskie Island Utility Company, Inc. (“DIUC” or “the Company”) for the Approval of an Adjustment in Rates and Charges for Water and Sewer Service (“the Application”). Filed on June 9, 2015, and pursuant to S.C. Code Sections 58-5-210 *et seq.*, and S.C. Code Ann. Regs. 103-514.4, Regs. 103-712.4, and Regs. 103-834 of the Commission’s Rules of Practice and Procedure, the Application seeks this Commission’s approval of a new schedule of rates and charges for water and sewer service.

DIUC is authorized by the Commission to be the exclusive provider of water and sewer service to a service area that encompasses Daufuskie Island, Beaufort County, South Carolina. According to water and sewer revenues reported in the Application for DIUC’s historical test year ended December 31, 2014, DIUC is classified as a Class A water and wastewater utility under the Uniform System of Accounts published by the National Association of Regulatory Utility Commissioners (“NARUC”) and prescribed by the Commission.

In considering the Application of DIUC, the Commission must ascertain and fix just and reasonable rates, standards, classifications, regulations, practices, and measurements of service to

be furnished. Thus, the Commission must give due consideration to the Company's total revenue requirement and review the operating revenues and operating expenses of DIUC to establish adequate and reasonable levels of revenues and expenses. The Commission will consider a fair rate of return for DIUC on the basis of the record, and any increase must be just and reasonable and free of undue discrimination.

II. PROCEDURAL HISTORY

In accordance with the Commission's requirements, the Office of the Clerk instructed the Company to publish an approved Notice of Filing, one time, in a newspaper of general circulation in the area affected by DIUC's Application. The Notice of Filing described the nature of the Application as follows:

[T]he current rates do not enable the Company to cover its cost of providing service and earn a fair return on its investment, and the Company has not applied for rate relief since 2012 and has not established unified rates under its current consolidated status. Daufuskie states that the proposed rates in its Application are essential for the Company to continue to provide its customers with adequate water and wastewater service. Further, the proposed rates would establish uniform rates for all of the Company's customers, including Haig Point and Melrose service area customers.

The Notice further advised all interested parties desiring to participate in the scheduled proceeding of the manner and time in which to file appropriate pleadings for inclusion in the proceedings as a party of record.

The Company was likewise required to notify directly, by U.S. Mail, each customer affected by the Application by mailing each customer a copy of the Notice of Filing. DIUC filed Affidavits of Publication demonstrating that the Notice of Filing had been duly published and provided a letter certifying that it had complied with the instructions of the Office of the Clerk and mailed a copy of the Notice of Filing to all customers.

On July 23, 2015, a Petition to Intervene was filed on behalf of the Haig Point Club & Community Association, Inc., Melrose Property Owner's Association, Inc., and Bloody Point Property Owner's Association, (collectively "Intervenors"). On July 27, 2015, a Petition to Intervene was also filed by Beach Field Properties, LLC ("Beach Field"), an owner of property within the DIUC service area. By letter dated July 31, 2015, the Intervenors requested the Commission schedule a public hearing "to provide a forum, at a convenient time and location, for the Utility's customers to present their comments regarding the services and rates of the Utility." The Intervenors further requested the hearing be held on Daufuskie Island at the Haig Point Club Clubhouse.

Pursuant to Commission Directive Order No. 2015-586, the Commission scheduled the requested night hearing and the Company provided affidavits certifying that it had provided notice to its customers via U.S. Mail of the date, time and location of the local public hearing. On September 15, 2015, the Commission held a night hearing at the Haig Point Club Clubhouse, 130 Clubhouse Lane, Daufuskie Island, South Carolina. During the hearing, statements were received from a number of customers and made part of the record in this proceeding. On October 28, 2015, the Commission, with Chairman Nikiya Hall presiding, conducted a hearing on the Application at the Commission's Hearing Room located at 101 Executive Center Drive, in Columbia, South Carolina.

At the hearing DIUC was represented by G. Trenholm Walker, Esquire and Thomas P. Gressette Jr., Esquire. The Intervenors were represented by John J. Pringle Jr., Esquire. Beach Field was represented by Margaret M. Fox, Esquire. The Office of Regulatory Staff ("ORS") was represented by Shannon Bowyer Hudson, Esquire and Andrew M. Bateman, Esquire.

After the hearing was called to order by Chairman Hall, Mr. Pringle asked to present a “preliminary matter” at which time he informed the Commission that the Intervenors and ORS had filed with the Commission a “settlement agreement.” Transcript at 40. Pursuant to the purported “settlement agreement,” ORS and the Intervenors agreed to stipulate to “all of the adjustments made by the ORS, with the exception that the ORS amended its bad debt allowance to utilize the allowance proposed by Daufuskie Island Utility Company, Inc. (the “Company”) in its Application. No other changes were made by ORS in reaching the Settlement.” *See* Transcript at 41-42.

DIUC objected to the purported “settlement agreement” asserting that the Commission should not consider it, take notice of it, or incorporate it into the record. *See* Transcript at 42-44. DIUC objected on the grounds that the “settlement agreement” endorses an even lower revenue number than originally proposed by ORS, that any agreement between ORS and Intervenors is irrelevant to the Application since the Company did not agree to the terms of the purported settlement agreement, and that admission of this particular “settlement agreement” is prejudicial to the Company. *Id.* The Commission overruled the Company’s objection.

DIUC presented the prefiled and summary testimony of John F. Guastella, President of Guastella Associates, LLC and Gary C. White, Vice President of Guastella Associates, LLC. *See* Transcript at 134-296 and 119-133. Guastella Associates LLC (“GA”) provides management, valuation and rate consulting services to water and wastewater utilities around the country, and has been the contract manager of DIUC (and its predecessors) since July 9, 2008.¹ DIUC also presented the prefiled and summary testimony of The Honorable Maria Walls, Treasurer of

¹ The stock purchase of Haig Point Utility Company, Inc. (now DIUC) by CK Materials LLC on July 9, 2008, from Haig Point, Inc. (formerly International Paper Realty Corporation of South Carolina) was approved by the Commission. The stock of DIUC was transferred from CK Materials, LLC to Daufuskie Island Holding Company, LLC in 2013 when the Commission approved DIUC’s financing with SunTrust Bank.

Beaufort County, and prefiled testimony of and Eric Johanson, Chief Operator of DIUC. *See* Transcript at 73-111 and 112-118.

The Intervenors presented prefiled and summary testimony of Charles Loy and Lynn M. Lanier, both of whom are principals with GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia. *See* Transcript at 347-464.

The Intervenors also presented prefiled and summary testimony of the following DIUC customers: Doug Egly, Tony Simonelli, Paul Vogel, and Harry Jue. *See* Transcript at 305-347.

Beach Field did not present any witnesses. When the Commission queried as to whether any members of the public wished to be heard, one witness, Mr. Reed Dulaney, addressed the Commission. *See* Transcript at 58-72.

ORS presented prefiled and summary testimony of Ivana C. Gearheart, ORS Audit Manager; Willie J. Morgan, Deputy Director of the Water and Wastewater Division of ORS; and Dr. Douglas H. Carlisle, Economist at ORS. *See* Transcript at 466-543.

Pursuant to motions by each party, all prefiled testimony was read into the record as if given orally.

III. FINDINGS OF FACT

1. DIUC is a water and sewer utility providing water and sewer service in its assigned service area on Daufuskie Island, Beaufort County, South Carolina. Its operations in South Carolina are subject to the jurisdiction of the Commission, pursuant to S.C. Code Ann. Sections 58-5-10, *et seq.*(1976), as amended.

2. The appropriate historical test year period for this proceeding, selected by the Company, is January 1, 2014, through December 31, 2014, adjusted for known and measureable changes.

3. Based on the application of DIUC and the evidence presented to the Commission by the Parties, the Commission will use the rate base/rate of return methodology in determining the lawfulness of the Company's rates and in fixing just and reasonable rates.

4. Certain revenue, operating expense, and rate base adjustments proposed by ORS were accepted by the Company as listed in Mr. Guastella's rebuttal testimony; these adjustments will be used by the Commission in calculating DIUC's revenue requirement.

5. The original cost of DIUC's utility plant that is used and useful in providing service to its customers is \$3,949,956 for water and \$4,189,304 for sewer.

6. The accumulated depreciation for plant in service is \$427,962 for water and \$347,197 for sewer and the annual depreciation expense related to the utility plant in service is \$40,859 for water and \$52,230 for sewer.

7. The appropriate level of customer contributions in aid of construction net of amortization is \$402,768 for water and \$183,932 for sewer.

8. There is no reasonable basis upon which to make a negative acquisition adjustment.

9. A fair and reasonable rate of return for the Company is 7.94%. The resultant operating margin is 16.1% which is also reasonable.

10. The Company is entitled to total rate case expenses of \$191,200, which is approximately one-half of the \$380,000 rate case expenses actually incurred in this rate case by DIUC as of October 28, 2015. Allowed rate case expenses shall be amortized over a period of four years, ($\$191,200 / 4 \text{ years} = \$47,800 \text{ per year}$).

11. The actual and known and measurable amount for Utility Property Taxes necessary to cover the eight year installment payments under DIUC's Settlement Agreement Addendum with

Beaufort County Treasurer and its ongoing annual amounts are \$65,855 and \$192,372, respectively.

12. The management of DIUC's operation under the management agreement with Guastella Associates, LLC has been more than adequate, particularly given the challenges faced by the Company; the requested management fees in the amount of \$171,364 are reasonable and may be recovered.

13. DIUC seeks an increase in its rates and charges for water and sewer service. Under DIUC's proposed rates, the additional total operating revenues would be \$1,182,301.

14. The appropriate operating expenses for DIUC after accounting and pro forma adjustments and adjustments for known and measurable changes total \$1,537,203.

15. Applying the fair and reasonable rate of return established in Finding #9, a 7.94% rate of return, the total operating revenue requirement for DIUC is \$2,089,652.

16. In order for DIUC to have the opportunity to earn its total operating revenue requirement of \$2,089,652, DIUC must be allowed additional revenues totaling \$1,016,071. Although this revenue amount is lower than the amount requested by the Company, it is sufficient and reasonable based upon the testimony presented by all the parties to this proceeding.

17. The Company's proposed "single-tariff" rate structure for its "Haig Point" and "Melrose" customers was unopposed, is fair and reasonable, and will be used to reflect rates that generate the allowed revenues as determined by the Commission.

18. The proposed "settlement agreement" offered at the hearing by Intervenors and ORS is hearsay and does not present any probative facts. It does not bind the Company. Both Intervenors and ORS proceeded on the merits and presented testimony in addition to the prefiled testimony of their respective witnesses. The testimony of the Intervenors' witnesses contradicted

the terms of the “settlement agreement” and the testimony of the ORS witnesses. As such, the proposed “settlement agreement” will not be considered, and the Commission will decide the matter based on the testimony and other exhibits entered into the record.

IV. EVIDENCE AND CONCLUSIONS

1. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 1

The evidence supporting this finding concerning the Company’s business and legal status is contained in the Application filed by DIUC, testimony, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. This finding of fact is informational, procedural, and jurisdictional in nature, and the matters which it involves are not contested by any party.

2. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 2

The evidence supporting this finding, that the appropriate historical test year period for this proceeding is January 1, 2014, through December 31, 2014, is contained in the Application filed by DIUC and in the testimony and exhibits of the Company, ORS, and Intervenors. No party contested the use of this historical test year proposed by DIUC in its Application. The Commission concludes that the historical test year ending December 31, 2014, is appropriate.

A fundamental principle of the ratemaking process is the establishment of a historical test year period. For ratemaking purposes, this Commission routinely examines the relationships between expenses, revenues, and investment in a historic test period because such examination provides a constant and reliable factor upon which calculation can be made to formulate the bases for determining just and reasonable rates. This method was recognized and approved by the South Carolina Supreme Court for ratemaking purposes involving utilities in *Southern Bell Telephone*

and Telegraph Company v. South Carolina Pub. Serv. Comm'n, 270 S.C. 590, 244 S.E.2d 278 (1978).

When the Commission considers a utility's proposed rate increase based upon occurrences within a test year, the Commission may also consider adjustments for any known and measurable out of test year changes in expenses, revenues, and investments, and the Commission will also consider adjustments for any unusual situations which occurred in the test year. *See Parker v. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984) (citing *City of Pittsburgh v. Pennsylvania Public Utility Commission*, 187 PA Super. 341, 144 A.2d 648 (1958); *Southern Bell v Public Service Commission*, 270 S.C. 590, 244 S.E.2d 278 (1978).

3. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 3

The evidence supporting this finding, that Commission should and will use the rate base/rate of return methodology in determining the lawfulness of the Company's rates and in fixing just and reasonable rates, is contained in the Application filed by DIUC and in the testimony and exhibits of the Company, ORS, and Intervenors.

"The 'rate base' is the amount of investment on which a regulated public utility is entitled to an opportunity to earn a fair and reasonable return." *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 101 n.2, 708 S.E.2d 755, 758 (2011). Rate base "represents the total investment in, or the fair value of, the used and useful property which [a utility] necessarily devotes to rendering the regulated services." *Id.* The rate of return on rate base is calculated by dividing the net income for return by the rate base. *Id.* Citing *Heater of Seabrook, Inc. v. Public Service Comm'n of S.C. (Heater of Seabrook II)*, 332 S.C. 20, 24 n.2, 503 S.E.2d 739, 741 n.2 (1998).

In its Application, DIUC requests rates be set on the basis of a rate of return on rate base ("rate base/rate of return"), similar to its most previous rate application. *See* Application for

Approval of Rates and Charges, January 10, 2012, Docket 211-229-WS. The Commission approved a settlement of DIUC's most recent prior Application based on rate base/rate of return and specified an operating margin as well as a rate of return on equity and the Company's rate base. *See* Order No. 2012-515, Docket 211-229-WS. In this proceeding, ORS and Intervenors also presented testimony as to their contentions regarding a suitable rate base and overall rate of return, including the cost of debt and rate of return on equity.

Neither S.C. Code Ann. Section 58-5-240, nor any other statute, prescribes a particular method to be utilized by the Commission to determine the lawfulness of the rates of a public utility. *See Porter v. South Carolina Pub. Serv. Comm'n*, 333 S.C. 12, 26, 507 S.E.2d 328, 335 (1998) ("It is within PSC's discretion to adopt the rate-setting method it believes is appropriate, provided that method complies with the statutes.") ((citing *Heater of Seabrook, Inc. v South Carolina Pub. Serv. Comm'n*, 324 S.C. 56 at 64, 478 S.E.2d 826, 830 (holding "PSC generally has wide latitude to determine an appropriate rate-setting methodology") and *Nucor Steel v. South Carolina Pub. Serv. Comm'n*, 312 S.C. 79, 85, 439 S.E.2d 270, 273 (1994) (holding "nothing in statute requires PSC to adopt any particular price-setting methodology in determining fair rate of return."))).

The Commission finds that the weight of the evidence, including the Application and testimony of witnesses Guastella, White, Gearheart, Carlisle, Loy, and Lanier as to their respective determinations associated with the rate base/rate of return, supports the use of a rate base/rate of return methodology in this case. The Commission further finds use of a rate base/rate of return methodology has allowed the Commission to determine fair, just, and reasonable service rates and charges for the Company.

4. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 4

The evidence supporting this finding, that certain revenue, operating expense, and rate base adjustments proposed by ORS were accepted by the Company as listed in Mr. Guastella's rebuttal testimony and that these adjustments will be used by the Commission in calculating DIUC's revenue requirement, is based upon the Application and testimony of witnesses Guastella, White, Gearheart, and Morgan.

In his rebuttal testimony, Mr. Guastella lists twenty (20) line items of revenue requirement adjustments proposed by ORS that he accepts on behalf of DIUC, as follows: Total Revenues, Wages, Benefits, Directors' Fees, Power, Chemicals, Supplies and Maintenance, Outside Services-Engineering, Outside Services-Accounting, Outside Services-Legal, Outside Services-Testing, Outside Services-Other, Transportation, Bad Debt, Insurance, Regulatory Commission Expense, Other A&G Expenses, Revenue Taxes, Payroll Taxes, and Average Unamortized Balances (the only rate base adjustment; the other 19 adjustments were made to revenues and operating expenses).

In her testimony for ORS, Ms. Gearheart relies on the testimony and exhibits of Mr. Morgan of ORS's Water and Wastewater Department for the adjustment for total revenues. The primary adjustment to revenues reflects the annualization of customers for the historical test year and the exclusion of the Company's allowance for growth in customers, along with other minor adjustments. The other adjustments accepted by DIUC are explained in Ms. Gearheart's testimony and were not subject to objection by the testimony of the Intervenor's witnesses.

As set forth in Ms. Gearheart's testimony, ORS initially asserted that the bad debt adjustment should be \$108,349, as opposed to the lower proforma adjustment in the amount of \$16,090 proposed by DIUC in its Application. Mr. Guastella testified that the Company was

willing to accept the bad debt adjustment by ORS and that it was more accurate than the Company's proposed adjustment based on the actual experience of the Company. *See* Transcript at 136-137. At the hearing, Ms. Gearheart changed her exhibits from her prefiled testimony in order to reflect the change as stated in the purported settlement agreement between ORS and Intervenors. *See* Transcript at 485-486.

Ms. Gearheart did not provide any explanation or analysis as to why she and ORS reversed its bad debt allowance and neither did any witness on behalf of the Intervenors, other than to make the testimony and Ms. Gearheart's exhibits consistent with the purported "settlement agreement." On the other hand, Mr. Guastella testified that he found ORS's initial bad debt allowance acceptable because it better reflects DIUC's actual experience than the conservative allowance he originally included in DIUC's application. Mr. Guastella testified that ORS's allowance of bad debts was about \$100,000, almost the same as the actual bad debt level of \$105,667 in the historical 2014 test year. He further testified that on the basis of updated financial data available at the time of his rebuttal testimony, the bad debts of the Company for the latest 12 month period were also about \$100,000. *See* Transcript at 136-137. The Commission has not been provided any support for ORS's rejection of its own original bad debt adjustment or the bad debt adjustment proposed by Intervenors. Mr. Guastella's testimony actually provides further support for the original ORS adjustment and the Commission finds that the original ORS bad debt allowance is fair and reasonable. We will, however, only increase the bad debts for additional revenues under the rates we allow herein to 50% of the existing ratio of bad debts to revenues as a more conservative measurable change for rate setting purposes in this case.

Accordingly, as demonstrated in the Application and testimony of witnesses Guastella, White, Gearheart, and Morgan, the Commission finds that the evidence supports that all of the 20

line item adjustments proposed by ORS and accepted by DIUC, as stated in Mr. Guastella's Rebuttal Testimony and his testimony before the Commission, are fair and reasonable and, thus, will be used by the Commission in determining the adjusted financials for the test year and DIUC's revenue requirement.

5. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 5

The evidence supporting this finding, that the original cost of DIUC's utility plant, which is used and useful in providing service to its customers is \$3,949,956 for water and \$4,189,304 for sewer, is based upon the Application and testimony of witnesses Guastella, White, Gearheart, and Morgan.²

The Application presents \$8,139,260 as the total cost of plant in service for water and sewer combined that is used and useful in providing service to the DIUC customers. *See* App. at Schedules W-B and S-B.

Ms. Gearheart proposes in her testimony with respect to Adjustment 10 that the Commission should reduce DIUC's gross plant in service by \$1,624,696 "to reflect capital improvements, non-allowable plant, adjustments from the previous case not made by DIUC and retirements through July 31, 2015." *See* Gearheart Direct Testimony at 9. Her description of Adjustment 10 in Audit Exhibit ICG-4, Page 5 states the adjustment is intended "[t]o remove undocumented expenses from gross plant in service" and shows the total reduction for "Combined Operations" of \$1,624,696 segregated between Water Operations and Sewer Operations in the amounts of \$1,353,024 and \$271,672, respectively. As Mr. Guastella pointed out, however, Ms. Gearheart does not identify nor provide any description or amount of the reductions she is

² Intervenors do not make adjustments to specific items of utility plant but propose treating large portions as CIAC, which will be addressed later.

proposing for the specific capital improvements, non-allowable plant, previous adjustments or retirements, on either a combined basis or separately for water and sewer operations.

Mr. Morgan provided some information regarding ORS's proposed adjustment when he testified that DIUC's 125,000 gallon elevated storage tank and facilities and the Bloody Point Well #1 are assets that were not included in ORS's rate base calculations, but he did not provide the specific costs of those assets that were used by ORS to reduce the Company's rate base. Mr. Morgan does not identify any other rate base adjustments. The Intervenors' witnesses' also propose adjustments to rate base, but they do not identify any specific assets or their costs.

Thus, neither ORS nor Intervenors have established a record upon which this Commission can make adjustments to the specific itemized costs of DIUC's utility plant in service. Moreover, the premises of ORS's adjustments are unclear. For example, Audit Exhibit ICG-4, Adjustment 10, attributes "undocumented expenses" as the reason for ORS's total reduction to plant in service. Yet, Mr. Morgan's direct testimony contradicts Ms. Gearheart's reason. He instead attributes a lack of ownership, not a lack of documentation, as the reason for the reduction of the cost (unstated) of the elevated storage tank, Bloody Point Well #1, and related facilities. These inconsistencies demonstrate contradictions among ORS's positions.

Rather than dismissing ORS's utility plant adjustments out-of-hand for failure to sufficiently present this Commission with non-contradictory evidence as to the specific items and their costs, we will address Mr. Guastella's rebuttal testimony in which he discusses ORS's utility plant adjustments, as he understands them on the basis of the ORS work papers provided to DIUC following ORS's audit exit conference call with the Company. *See* John F. Guastella Rebuttal Testimony at 5.

A. Elevated Storage Tank, Well, and Related Facilities

ORS does not dispute that the elevated storage tank, well, and related facilities have continued to be used and useful since their installation, and ORS has not presented any testimony to contradict the proof of cost of these facilities entered into evidence by DIUC nor that the cost attributable to each of these assets of the Company is reasonable.

In his direct testimony, the only reason Mr. Morgan offers to exclude the cost of these facilities on the elevated tank site parcel is that documents obtained online from Beaufort County identify the tax sale deed of the real property parcel showing an owner different from the Company; he then concludes that DIUC does not own the utility facilities located on the parcel. *See* Prefiled Direct Testimony of Willie J. Morgan at 7.

In his rebuttal testimony, Mr. Guastella testified as to the ownership of the elevated storage tank, well, and related facilities:

DIUC owns those facilities and they were never sold, as reflected in a Special Warranty Deed and Bill of Sale dated April 1, 2001 by and between Haig Point, Inc. and Haig Point Utility Company, Inc. See Exhibit 1. DIUC's initial and supplemental response to ORS Request #1.79 documents that DIUC, as the successor utility to Haig Point Utility Company, Inc. ("HPUC"), has the right to construct, operate, maintain and replace utility facilities on any parcel of land on the 1,040 acres of the Haig Point Plantation being developed by Haig Point, Inc., formerly International Paper Realty Corporation of South Carolina, provided there were no existing plans for a building construction. See Exhibit 2. The approved joint application of Haig Point, Inc. and CK Materials LLC for the sale of the stock of HPUC includes on Schedule 3.13(a), page 3, the cost of the storage tank and well in the amount of \$1,303,083.97. The Beaufort County property record reflected in Exhibit WJM-7 does not include any of DIUC's utility facilities. Moreover, the testimony of Maria Walls, Treasurer of Beaufort County, confirms that Beaufort County did not sell DIUC's storage tank, well, pump, pipes and other utility facilities in the tax sale to Mr. Sabry, and that Mr. Sabry is not paying property taxes on those utility facilities. DIUC, however, is paying Utility Taxes for them on the basis of assessments by the Department of Revenue ("DOR"). The original cost of these facilities is reflected on DIUC's books and they have continued to be used and useful, without interruption, in providing water service to DIUC's customers since they were first placed into service.

See Transcript at 201-202.

In addition to this testimony of Mr. Guastella, Beaufort County Treasurer Maria Walls confirmed that the tax deed for the real property did not convey DIUC's facilities to Mr. Sabry and that the South Carolina Department of Revenue ("SCDOR") includes the tank and facilities as part of the DIUC system for assessment of the Utility Property Tax. *See* Transcript at 82- 83. We find the testimony of Treasurer Walls persuasive on this issue.

Upon review of Mr. Morgan's Exhibit WJM-7 and upon consideration of Ms. Walls' testimony and the testimony of Mr. Guastella, the Commission cannot conclude that DIUC does not own those utility facilities on this real property. Accordingly, ORS's position that DIUC lacks ownership of the elevated storage tank, well, and related facilities is rejected as a basis for deducting the cost of those facilities from utility plant in service. Again, there has been no testimony to dispute that the elevated tank and associated facilities are used and useful in providing water service to DIUC's customers. They are devoted to providing water service and their value is calculable. Based upon the testimony of Ms. Walls and Mr. Guastella and after thorough analysis of the testimony of witnesses White, Gearheart, and Morgan, we find that the elevated storage tank, well, and related facilities are used and useful, DIUC has control of those facilities, and their cost as proposed by DIUC is reasonable.

Even though title to the land and title to the utility facilities are separate, the Commission also notes that DIUC has initiated condemnation proceedings to re-acquire legal ownership of the real property and the court has ruled that such condemnation is legally proper. *See* Transcript at 52. Upon initiation of these proceedings, the Company had a right to possession of the land. "A condemnor may take possession of property: ... (3) upon deposit with the clerk of court in the

county in which the property to be condemned is situated, the amount stated in the Condemnation Notice as just compensation for the property, the amount having been determined by the condemnor pursuant to § 28-2-70(a) before initiating the action.” S.C. Code Ann. § 28-2-90(3).

The Commission also rejects Mr. Morgan’s alternative reason for excluding the elevated storage tank, well, and related facilities based upon the gross value used by the SCDOR to assess DIUC’s Utility Tax for the years 2012 and 2013. In his surrebuttal testimony, Mr. Morgan proposes that “DIUC should not be allowed to earn a return on the elevated storage tank for ratemaking purposes while at the same time having taken action that could reduce property taxes by revising annual reports to deduct a value corresponding to the elevated storage tank value.” *See Surrebuttal Testimony of Willie J. Morgan at 516-517.*

We disagree in principle with Mr. Morgan’s assertion that SCDOR tax assessment values are both relevant and controlling for our rate making analysis. The Commission’s analysis of ratemaking must be based on the allowance of return on the actual net investment of used and useful plant, which is not the same as a value assessed for taxation. This Commission is hesitant to endorse using tax assessment values for ratemaking purposes as such assessments do not reflect the actual cost of facilities that are used and useful in providing service. Further, in this instance, it would be counter-productive to penalize DIUC for its actions to reduce property taxes that benefit the ratepayers.

Additionally, even if the values the SCDOR to assess DIUC’s Utility Tax were to be considered, the revised Schedules 201 of the annual reports, Surrebutal Exhibit WJM-1, Pages 2 and 4, for 2012 and 2013, respectively, clearly state that the values included reflect the rate base allowed in DIUC’s last rate case, Docket No. 2011-229-WS, not the actual book cost of utility plant in service for those years, and also not the book costs reflected in the supporting schedules

submitted by DIUC in this rate case. A review of the differences in the totals between the original and revised Schedules 201 for 2012 and 2013, demonstrates pro-rata adjustments to the list of primary plant accounts, and do not support the assertion by Mr. Morgan that SCDOR reduced the overall assessed value by \$863,379 for the cost of the elevated storage tank as Mr. Morgan states in his testimony. *See* Transcript at 515. Indeed, the original Schedules 201 show \$863,379 in Account 330.4 Distribution Reservoirs and Standpipes, but the revised schedules still show in excess of \$600,000 in that account, which contradicts Mr. Morgan's statement that the differences correspond to the \$863,379 value for the elevated tank as identified in Docket No. 2011-229-WS.

Finally, the settlement in Docket No. 2011-29-WS does not indicate the components of the \$5.0 million rate base; there is no mention of the elevated storage tank or its cost in that approved settlement. *See* Order No. 2012-515, Docket 211-229-WS. The settlement also states:

3. The Parties agree and stipulate that DIUC shall be allowed to set rates and charges on a rate base of \$5,000,000. This stipulated rate base shall not be binding in future proceedings, instead those proceedings will be determined based on the evidence presented in each docket and the applicable law.

See Order No. 2012-515, Docket 211-229-WS, and attached Settlement Agreement. By asking this Commission to use the SCDOR assessment, which is based on Order No. 2012-515, Docket 211-229-WS, ORS essentially asks the Commission to do what ORS agreed not to do -- to use the \$5,000,000 rate base as evidence in this later rate case.

For all of the reasons stated above, the Commission finds the elevated storage tank, well, and related facilities have continued to be used and useful since their installation and should be included as part of the DIUC plant in service.

B. Bloody Point Well #1

ORS proposes an adjustment to plant in service to exclude Bloody Point Well #1. The sole reason offered by ORS is found in Mr. Morgan's direct testimony wherein he states that documents obtained online from Beaufort County indicate a party other than DIUC owns the real property on which Bloody Point Well #1 is located. *See* Direct Testimony of Willie J. Morgan at 7. Mr. Guastella's rebuttal testimony, however, responds to Mr. Morgan's claim that the Bloody Point Well is not owned by DIUC. Mr. Guastella cites two grounds for inclusion of the well in DIUC's plant in service.

First, Exhibit 3 to Mr. Guastella's rebuttal testimony is an Indenture Grant of Easement and Bill of Sale for Personal Property between the Bloody Point Group Limited Partnership and Melrose Utility Company. This uncontradicted exhibit establishes that the Company possesses an easement over the real property for access, use, and operation of its facilities. This exhibit also demonstrates the Company holds title to those facilities by virtue of the bill of sale. Second, Mr. Guastella testified that the Bloody Point Well #1 is reflected on DIUC's books and it has continued to be used and useful in providing service to the Company's customers. *See* Transcript at 287 (testimony of Mr. White as to "original cost numbers in the books and records of International Paper" which were transferred to DIUC's books.).

The rate base we seek to determine must include "the total investment in, or the fair value of, the used and useful property which it necessarily devotes to rendering the regulated services." *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 101 n.2, 708 S.E.2d 755, 758 (2011). After consideration of Mr. Guastella's testimony and the Indenture Grant of Easement and Bill of Sale for Personal Property between the Bloody Point Group Limited Partnership and

Melrose Utility Company, the Commission rejects the adjustment proposed by ORS and finds DIUC may include the cost of the Bloody Point Well #1 in its utility plant in service.

C. Absence of Invoices for Certain Facilities

Again, as previously discussed, Ms. Gearheart's testimony does not itemize the specific assets or their costs that are the basis of ORS's proposed adjustments to utility plant in service. Rather than dismissing ORS's utility plant adjustments out-of-hand for failure to present evidence as to the specific items and their respective costs it proposes be removed, we will address Mr. Guastella's rebuttal testimony in which he discusses ORS's utility plant adjustments, as he understands them based on the ORS work papers provided to DIUC following ORS's audit exit conference call with the Company. *See, infra*, John F. Guastella Rebuttal Testimony at 5.

According to Mr. Guastella's rebuttal testimony, information provided to DIUC by ORS indicates a portion of ORS's total adjustments to utility plant relates to the absence of invoices confirming the original construction costs of particular facilities used and owned by the Company. Mr. Guastella testified, however, that the absence of those invoices does not constitute a lack of documentation of cost for ratemaking. *See* Guastella Rebuttal Testimony at 6. Mr. Guastella explained that DIUC provided ORS with itemized assets, by primary plant account, description, original costs as booked, year of installation and in service dates. *See* Transcript at 150-153. Mr. Guastella also testified at the hearing it was the now defunct Melrose Utility Company that failed to retain many of the invoices sought by ORS. *Id.*

The Commission agrees with Mr. Guastella that lack of invoices does not necessarily constitute an absence of evidence as to the reasonableness of the cost of a utility's assets that are providing service. With regard to documentation, Mr. Guastella testified at length as to how DIUC documented the costs by providing documentation from its books and records as to the cost of

plant and identification of the plant. *See* Transcript at 151-152. The absence of invoices is not equivalent to a total absence of documentation of the cost of these particular assets that are in service.

Mr. Guastella also testified that it is consistent with the NARUC Uniform System of Accounts (“NARUC USoA”) to estimate the cost of utility plant in the absence of the original documentation, pointing out that Intervenor’s witness, Mr. Loy, also made that observation in his testimony with respect to another issue. Mr. Loy testified that “The NARUC USoA requires an ‘estimate’ of plant values when there is no supporting documentation available.” *See* Transcript at 385. When asked on cross-examination about this estimating procedure, Ms. Gearheart testified that she was not aware of that provision in the NARUC USoA. *See* Transcript at 530.

The Commission finds that based upon the Application and the testimony of witnesses Guastella, White, Gearheart, and Loy, ORS’s adjustment for “undocumented expenses” is not supported and is rejected.

D. Capitalized Legal and Consulting Fees

Another element of Ms. Gearheart’s proposed reduction of utility plant in service relates to legal and consulting fees. The following questions and answers in Mr. Guastella’s rebuttal testimony provide a thorough factual summary of the circumstances that created the need for legal and consulting fees, and Mr. Guastella’s justification for including the fees as part of the cost of utility plant in service:

- Q. What adjustments did the ORS propose with respect to legal and consulting fees that are reflected in DIUC’s utility plant in service?**
- A. Ms. Gearheart’s testimony and exhibits do not specifically identify the amounts of those adjustments. They are lumped in with her adjustment to utility plant in service. It is our understanding that she proposes to eliminate the legal fees incurred in connection with the condemnation of the Sabry parcel and to eliminate GA consulting fees that were capitalized. I would

note that Ms. Gearheart's statement that the legal costs of \$29,511 were for condemnation of the water tower is incorrect. DIUC is condemning the land, not the water tank that DIUC already owns.

Q. Why was the condemnation action required?

A. When we learned of the tax sale of the storage tank parcel, our first reaction was to reason with Mr. Sabry. When that was unsuccessful, we filed a legal action to reverse the tax sale. Subsequently, however, our attempt to finance with CoBank and then Wells Fargo fell through, and our need to obtain financing for capital improvements had to be our primary objective. It became evident that the proceeding to reverse the tax sale would be drawn out and result in an unacceptable delay in obtaining a loan. The best course of action was to withdraw the law suit and initiate a condemnation, an action that SunTrust would accept -- and made it a requirement of the loan.

Q. Why should the legal fees be included in the cost of providing service?

A. The tax sale was beyond our control. Upon managing DIUC, we notified Beaufort County of the new address, and we received regular property tax bill from Beaufort County at that address. For an unknown reason, Beaufort County sent a tax bill for the storage tank parcel of land to the wrong address without our knowledge, as well as notices of a delinquency and a tax sale. It even posted a notice of the tax sale at the wrong property, and our operators never observed any notice at the storage tank site which they visit daily. The legal fees were, therefore, unavoidable and included in the cost of land.

Q. Why should GA's fees related to capital improvements be included in the cost of providing service?

A. GA's management agreement contains a provision under which work performed in connection with capital improvements is not part of the routine day-to-day management of DIUC and, therefore, would be billed at 10% of the first \$50,000 of improvements and 8% of capital costs over \$50,000. The work involves establishing the improvements that are needed or desirable, establish priorities in terms of their impact on service and available funding cost, solicit and obtain contractors' proposals, select contractors, schedule and coordinate work with DIUC's routine operations, and supervise the construction work.

Q. Did ORS provide any reason for eliminating GA's fees related to capital improvements?

A. Not that I could find.

Q. Why should GA's fees related to capital improvement be included in rate base as part of the cost of the improvements to utility plant is service?

- A. GA's capital fees are not only part of an arms-length management agreement, they are necessary and the cost is reasonable. It is obvious that capital improvements cannot be made without the work I describe above. The 10% and mostly 8% of the construction costs are significantly less than the 15% to 20% typically allowed for administration and supervision of construction work.

See Transcript at 204-206.

In reply to DIUC's discovery requests, ORS agreed that: (1) the consulting services related to capital improvements were performed; (2) the consulting services related to capital improvements were in accordance with provisions in GA's management agreement with DIUC; and (3) the facilities to which those consulting services related are used and useful in providing service to DIUC's customers. *See* Response to Company's First Set of Interrogatories and Requests for Production to ORS at #3, Exhibit 10 to Transcript. Mr. Guastella also testified that the work performed by GA was necessary to initiate, implement, supervise and account for capital improvements.

On the basis of the record in this case, we reject ORS's adjustment to utility plant in service related to legal and consulting fees that were added to the capital costs of utility plant in service. We find the Company's inclusion of these in the test year as well as the amounts used to be fair and reasonable.

E. Land Values

With regard to land values, we learned from Mr. Guastella's rebuttal testimony that part of Ms. Gearheart's proposed reduction of total utility plant in service relates to land owned and/or used by the Company for which no value was recognized by ORS. Mr. Guastella testified that the land value included in utility plant in service for all of DIUC's land is \$109,560, which includes \$3,700 related to the elevated storage tank site but excluding capitalized legal fees, determined on

the basis of an appraisal by an independent land appraiser who was used to value the site of the elevated storage tank. *See* Transcript at 206-207. The actual value asserted by DIUC in Mr. Guastella's testimony was not challenged, nor was the reasonableness of the land value. As indicated previously herein, the Commission finds that the real property included by DIUC in plant in service is used and useful. Further, ORS has not presented any testimony that the per-acre, appraisal-based cost proposed by DIUC is unreasonable. On the basis of the record in this case, we find that DIUC's submitted values for this land are fair and reasonable and reject ORS's proposed adjustment to utility plant in service related to land values.

In summary, Finding of Fact #5, that the original cost of DIUC's utility plant that is used and useful in providing service to its customers is \$3,949,956 for water and \$4,189,304 for sewer, is based upon the Application, discovery responses, and testimony of witnesses Guastella, White, Gearheart, Loy, and Morgan. ORS's proposed reduction to total utility plant in service on a combined basis and for water and sewer operations is denied.

6. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 6

The evidence supporting this finding, that the accumulated depreciation is \$427,962 for water and \$347,197 for sewer and that the annual depreciation expense related to the utility plant in service is \$40,859 for water and \$52,230 for sewer, is based upon the Application and testimony of witnesses Guastella and White.

Both DIUC and ORS use the system utilization factor methodology for calculating depreciation expense and accumulated depreciation. ORS uses slightly different depreciation rates, but does not explain the reason for the differences. The level of depreciation expense and accumulated depreciation depend on the amount of utility plant in service that the Commission has accepted for rate setting purposes. Because we have accepted DIUC's utility plant in service,

without adjustment, we will accept its depreciation rates and resultant depreciation expense and its accumulated depreciation in determining rate base.

Intervenors' witness, Mr. Loy, disagrees with the use of the utilization factor in calculating depreciation expenses, which he proposes should be based on full depreciation rates. *See* Transcript at 371. Mr. Loy also proposes to increase DIUC's booked accumulated depreciation, which he asserts is necessary in order to comply with GAAP and the appropriate accounting used for setting rates. *See* Transcript at 372. Finally, Mr. Loy alleges that the Company's booked accumulated depreciation does not properly reflect the age and condition of the plant. *See* Transcript at 404-405.

In support of his positions, Mr. Loy relies on the testimony of Harry Jue, who is a DIUC customer and former employee of the City of Savannah where he served as the Water and Sewer Bureau Chief for 31 years. Mr. Jue inspected the water and wastewater systems, and on the basis of his observations, assigned an accumulated depreciation of 30% of the total cost of utility plant in service. *See* Transcript at 362-363.

On the basis of Mr. Jue's analysis, Mr. Loy proposes to increase accumulated depreciation and establish a deferred amount of accumulated depreciation of \$316,142 for water and sewer combined (\$141,194 for water and \$174,948 for sewer), which he states the Company should be able to recover over seven years, or \$45,000 annually. *See* Transcript at 379.

Mr. Guastella responds to Mr. Loy's position on depreciation in rebuttal, focusing on the characteristics and nature of newly formed developer-related water and sewer utilities that were created as part of a new real estate project. *See* Transcript at 160-163, 206-209. Mr. Guastella testified that he developed the system utilization factor methodology for depreciation along with the complete system analysis in setting rates for water and sewer utilities for developer-related

utilities. *See* Transcript at 208. His motivation to do so was based on his experience regulating some 400 small, mostly developer-related water and sewer utilities, after he observed the difficulty they invariably had in attracting capital on the strength of their own financial condition once the real estate development was completed. Mr. Guastella testified that he continued using a complete system analysis as a consultant so that the existing utility customers would not subsidize the cost of the real estate project or even bear the risk of the success of the real estate project. Mr. Loy's approach places the burden of depreciation of the Company's entire plant in service on a fraction of the utility's ultimate customer base. Mr. Guastella explained that the complete system analysis which bases depreciation on system utilization (i.e., actual utilization as a percentage of capacity rather than the full level of depreciation), mitigates the problem of newly formed developer-related utilities that have insufficient revenues during the growth years with which to cover operating expenses, including depreciation. Accordingly, the book value would not be understated after completion of the real estate project, leaving the utility in a weak financial position. *See* Transcript at 207-210.

Mr. Guastella also responded to Mr. Loy's position that DIUC's accumulated depreciation does not properly reflect the age and condition of the plant. In rebuttal, Mr. Guastella testified that depreciation is caused not only by wear and tear, action of the elements, and decay (the physical condition) but also changes in art, obsolescence, and changes in regulatory requirements. *See* Transcript at 209.

The testimony of Mr. Guastella demonstrates his significant experience with newly formed developer-related utilities and the calculation of depreciation rates and expense. His testimony further establishes that the use of the complete system analysis used by him and ORS is fair and reasonable.

In his surrebuttal testimony, Mr. Loy does not accept Mr. Guastella's reasoning for the complete system analysis claiming that it is a concealed request for rate base treatment of deferred depreciation expense because it is improperly reflected in the books for regulatory and rate making purposes. *See* Transcript at 403. The Commission does not agree that the Company's request conceals its position on depreciation, or the impact on expenses and rate base. DIUC's Application clearly sets forth the utilization factor methodology for calculating depreciation expense and rate base, and ORS not only understands the Company's method of calculation but concurs in it. *See* Transcript at 494. The Commission fully understands that the depreciation expense allowed for rate setting will be lower due to the utilization factor, and that the rate base will be higher because of the commensurate reduction of accumulated depreciation related to a lower level of depreciation expense. We also find that the revenue requirement will be less under the system utilization factor methodology because the lower depreciation expense has more of an impact than the additional return related to the incrementally higher rate base.

Mr. Loy also states that application of the utilization factor extends the book value of the DIUC assets beyond their useful life. *See* Transcript at 364. The "useful" life or average service life of DIUC's assets on a composite basis or for individual primary plant accounts, is not known but instead is estimated on the basis of depreciation studies. Such studies account for the fact that some units of depreciable assets will be retired before and some after the average service life on which depreciation rates are, in part, established. Utilities ultimately stop taking depreciation on accounts that are fully depreciated, so that they never recover more than the original cost of the depreciable assets. As Mr. Guastella testified, depreciation rates can be revised over time to reflect a range of average service lives, and it would not be unreasonable at some point to increase the depreciation rates. *See* Transcript at 209. This Commission's rate setting authority includes the

establishment of allowances for depreciation that takes into account all elements affecting depreciation rates.

Accordingly, we find that the system utilization factor methodology for depreciation as used by DIUC and the ORS is reasonable and beneficial to the customers for rate setting purposes in this case.³ As such, we find the accumulated depreciation for plant in service is \$427,962 for water and \$347,197 for sewer. We further find the annual depreciation expense related to the utility plant in service is \$40,859 for water and \$52,230 for sewer.

7. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 7

The evidence supporting this finding, that the appropriate level of customer contributions in aid of construction net of amortization is \$402,768 for water and \$183,932 for sewer, is based upon the Application and testimony of witnesses Guastella, White, Gearheart, and Loy. ORS proposes to reverse the Company's increase in contributions in aid of construction (CIAC). Although the Company is silent as to this adjustment, it did accept ORS's adjustments for growth with respect to both revenues and expenses. We will, therefore, accept ORS's adjustment to CIAC. The ORS proposes only a very small adjustment of \$216 to the Amortization of CIAC, which slightly increases rate base, but it is primarily due to its depreciation rates that we will not use and, therefore, we do not accept its adjustment to the amortization of CIAC.

Intervenors assert that a large part of the utility plant should be treated as CIAC, surmising that it was contributed by International Paper to HPUC. In support of this contention, Mr. Loy

³ While we base our conclusions on the merits of the testimony of the witnesses, we are mindful of their qualifications and experience in weighing their respective opinions. Mr. Jue has never performed a depreciation study to establish average service lives, salvage values or depreciation rates, nor has he been qualified as an expert in depreciation in a rate proceeding. Mr. Loy has never performed a depreciation study using the actuarial or simulated plant balances methods, has never worked for a regulatory agency or developer-related water or sewer utility, and has never prepared initial rates for a newly formed water or sewer utility. Intervenors' Responses to DIUC Second Interrogatories and Requests for Production, Hearing Exhibit 10.

testified that in his opinion, “the majority of plant purchased by DIUC from HPU should be reflected as Contributions in Aid of Construction (CIAC), not as invested plant.” Transcript at 379. That is incorrect. DIUC did not purchase the plant from HPUC; instead, this Commission approved the purchase of the *stock* of HPUC by CK Materials LLC from Haig Point, Inc. which Mr. Loy later recognized in his direct testimony.

With respect to Mr. Loy’s opinion, Mr. Guastella stated in rebuttal:

Q. When you prepared the last rate analysis on behalf of DIUC, did you find anything unusual in the relationship between Haig Point, Inc. and HPUC as reflected on the balance sheet as of December 31 2007 before the acquisition by CK Materials?

A. No. I found what I have always found for the hundreds of my developer-related utility clients. When a water or sewer utility is created as part of a real estate project, it has no customers and no revenues, because the utility system has not yet been constructed. The developer owner, individual or corporate, funds the construction of the utility system. At some point, sooner or later – it doesn’t matter, the assets are transferred from the developer to the utility at their original cost and a liability is reflected on the utility’s books in some form of open account, typically as Advances in Aid of Construction or some other named contributed capital account, which represents the developer’s equity investment. In sum, there is absolutely no indication that there were customer contributions in aid of construction as defined in the NARUC USoA, and Mr. Loy’s proposal to assume contributions is simply unsupported with any substantive analysis.

Transcript at 211-212.

Mr. Guastella also addressed the erroneous assumptions by Mr. Loy regarding contributions by International Paper, as follows:

Q. Do you agree with Mr. Loy’s analysis to support his position that the plant should be treated as contributed?

A. No. Mr. Loy’s analysis is a fabrication. Mr. Loy begins his analysis by claiming that Haig Point, Inc. treated the utility plant as inventory and expensed these costs as development costs. He provides no support for that statement, and it’s rather far-fetched. Under the tax code, one affiliate cannot expense plant for tax purposes and then transfer it to an affiliate who depreciates the cost that was

already expensed. On page 14 of his testimony, Mr. Loy states that “Working with Mr. Guastell, (sic), HPUC developed an original cost trending study...” That never happened! On page 19, Mr. Loy states that “Mr. Guastella probably inventoried the plant and identified certain records that helped date the plant. He probably then performed an original cost trending study...” Again, that never happened! GA was retained by HPUC in 2004 only to prepare a rate analysis, which we did on the basis of information provided by HPUC’s representatives. HPUC’s rate application was examined by the ORS and it prepared a report of its audit, which included the following:

“AUDIT EXHIBIT SGS-10; BALANCE SHEET

Shown in this exhibit is the balance sheet of HPUC as of June 30, 2004. ORS verified the balances contained in this statement to the books and records of HPUC.”

On page 18, Mr. Loy states that “HPUC hired Mr. Guastella to ready HPUC for sale.” Not true! I never knew there would be a sale until 2008 when a member of CK Material LLC contacted me to help him purchase HPUC.

Intervenor’s position regarding contributions is not consistent with the books and records of DIUC or its predecessor HPUC, and is not accepted.

On the basis of the evidence and the merits of the testimony and relative expertise of the witnesses regarding developer-related utilities, we will accept ORS’s adjustment to CIAC but not ORS’s adjustment to the amortization of CIAC.

8. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 8

The evidence supporting the finding that there is no reasonable basis upon which to make a negative acquisition adjustment is based upon the Application and testimony of witness Loy.

Mr. Loy recommends in his surrebuttal testimony that if the Commission finds that International Paper did not donate the water plant in service to HPUC and CIAC was not misclassified, then a negative acquisition adjustment should be made in rate base only if there is a good reason to do so. *See* Transcript at 411-412. Typically, positive acquisition adjustments are considered under special circumstances to encourage large water utilities to acquire small troubled

water utilities in order to improve service. In his direct testimony, Mr. Loy states that a negative acquisition adjustment should not be made; that many Commissions exclude either a positive or negative acquisition adjustment in order to maintain a consistent original cost standard; and that he believes as a general rule of thumb that including a negative acquisition adjustment in rate base will cause more harm than good, unless there is a good reason to do so. *See* Transcript at 392. We also note that this Commission did not impose an acquisition adjustment in the prior rate proceeding and further that in their purported settlement agreement neither ORS nor the Intervenor advocates advocated for an acquisition adjustment. In this case we believe that a negative acquisition adjustment would harm DIUC. We therefore find that no acquisition adjustment should be made.

9. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 9

The evidence supporting this finding -- that a fair and reasonable rate of return for the Company is 7.94%, resulting in an operating margin of 16.1% which is also reasonable, is based on the testimony of witnesses Guastella, Carlisle, and Lanier.

Before addressing the specific rate of return, the Commission must address the cost of capital of the Company with respect to the Company's debt and the true cost of that debt. Mr. Guastella testified that the Company must refinance the existing \$2,750,000 term loan with SunTrust in order to pay off the existing \$500,000 line of credit that is due, to fund additional capital improvements, and to reduce accounts payable. The intended financing would be a \$3,750,000 term loan, increasing the portion of debt in DIUC's capital structure, which will have the benefit of lowering the overall cost of capital and income taxes. *See* Transcript at 192.

In his analysis Mr. Guastella used a debt rate of 6.2%, which he refers to as the "effective" interest rate of the existing SunTrust term loan. *See* Transcript at 193. Mr. Guastella used "effective

interest rate” to refer to the actual cost of the loan – the interest rate charged on the amount borrowed as well as the known and measurable costs associated with obtaining and closing the loan. This effective interest rate was calculated by amortizing the costs of undertaking the existing loan over 15 years and adding the annual amount to the stated 5.29% interest. On the basis of the total capital on the Company’s balance sheet, DIUC’s proposed \$3,750,000 equates to a debt ratio of 41.2% and an equity ratio of 58.8%. *See* Transcript at 193.

Noting that small water and sewer utilities rarely, if ever, obtain financing on the strength of their own financial condition, particularly those as small as DIUC, Mr. Guastella proposes an equity rate of return of 10.5% and on the basis of his experience and judgment with respect to small water and sewer utilities testified that:

... the return to the equity holder should be commensurate with risks on investments in other enterprises having corresponding risks and that equity return should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital. That standard is not satisfied if DIUC’s equity return would be determined by applying such typical rate of return analyses as the discounted cash flow method or capital asset pricing model. Those methods have value for large utilities but not for DIUC. For example, in the last rate case the settlement included a return on equity of 8.81% which was estimated to produce some \$176,215 in net income. The rate increase went into effect on August, 15, 2012. From August 15, 2012 to December 31, 2014, DIUC’s net income should have been a total of about \$418,000 if it achieved the 8.81%, but instead its actual net income was less than \$90,000 for that period. For 2015, we project a loss of about \$450,000.

Transcript at 193-194. We find Mr. Guastella’s testimony persuasive and that it demonstrates the sensitivity to earning erosion issues that this Commission must consider when evaluating rate applications for small utilities like DIUC.

Mr. Guastella proposes an overall rate of return of 8.73%. *See* Transcript at 126-127 and Schedule A-3. ORS proposed an overall rate of return that equates to 7.46%.⁴ *See generally* Testimony of Douglas H. Carlisle, Transcript at 467-484 and 520-522.

The ORS recommendations regarding cost of capital and rate of return were presented by Dr. Douglas H. Carlisle who proposes a rate of return on equity of 9.31% and an interest rate on debt of 5.29%, which is the rate charged by SunTrust. *See* Transcript at 474. Dr. Carlisle suggests we use “the average capital structure used by water companies in the United States with publicly traded stock (Common Equity). That ratio is 46% Long-Term Debt and 54% Common Equity.” Transcript at 473 citing Exhibit DHC-1. Dr. Carlisle’s debt rate is limited to the stated interest rate of the SunTrust term loan, without adjustment for any of the costs that we know must be incurred by DIUC in order to obtain that loan. Next, because Dr. Carlisle also considers the Company’s intended refinancing in the amount of \$3,750,000 to be speculative, he uses an imputed debt/equity ratio on the basis of an average capital structure of water utilities in the United States whose stock is publically traded. *See* Transcript at 473. For his proposed equity rate, Dr. Carlisle used the Comparable Earnings Model (CEM), the Discounted Cash Flow (DCF) Model, and the Capital Asset Pricing Methods (CAP-M). *See* Transcript at 474-475.

On the other hand, Mr. Guastella disputes Dr. Carlisle’s decision to base ORS’s position on use of publicly traded companies on the grounds that the publicly traded companies’ data are not comparable. *See* Transcript at 221. The Commission is likewise wary of the comparison proposed by ORS, since the only grounds offered to support the same are that “there is more data on publicly traded companies than on private held companies” and Dr. Carlisle “used publicly

⁴ Although an overall rate of return is not included in the testimony of Dr. Carlisle, using his proposed debt and equity rates and capital structure ratios, the overall rate of return equates to 7.46%.

traded water utilities since they are in the same line of business as DIUC and share similar risks.” *See* Transcript at 475. The record and testimony in this case demonstrate the many reasons why the Company is quite dissimilar from the large publicly traded utilities providing the data Dr. Carlisle relies upon; at the very least, the risk of investing in DIUC is much greater than an investment in these significantly larger publicly traded corporations.

The Intervenor’s position on rate of return is provided through the testimony of Mr. Lanier. With respect to the Company’s proposed interest rate of 6.2%, Mr. Lanier states “that while this rate is relatively high in the current interest rate environment, this is probably a reasonable rate for DIUC, given its precarious financial state.” *See* Transcript at 436. With respect to a rate of return on equity, Mr. Lanier refers to a number of sources: a Connecticut Department of Public Utility Control test that produces a 10.69% equity rate of return formula that adds basis points for small utilities and performance⁵; a Florida Public Service Commission leverage formula that suggests a range of ROE from 7.79% to 11.51% depending on equity ratios of 100% to 40%, respectively; and Dr. Carlisle’s recent testimony in the United Utility Companies rate case with a range of 8.86% to 9.60%, wherein the Commission settling on 9.35%. *See generally* Transcript at 439. Ultimately, Mr. Lanier proposes an equity rate of 8.75%, which is the mid-point of his lower range of reasonableness. His overall rate of return is 7.28% on the basis of a capital structure consisting of 57.55% debt and 42.45% equity. *See* Lanier Exhibit Three, Schedule C-3. Mr. Lanier justifies his recommendation of a rate of return on equity at the low end of his proposed range of reasonableness because he believes that the Company has demonstrated a degree of irresponsibility in its operations and use of debt funds since the last rate case that warrants the use of a low end of

⁵ Mr. Lanier could not locate the reference but does not suggest it does not exist.

the range of reasonableness for the rate of return on equity. We do not find the record demonstrates DIUC has improperly handled its debt and we do not agree that DIUC's rate of return on equity should be adjusted as suggested by Mr. Lanier.

We find that DIUC's intent to refinance the existing debt with a \$3,750,000 term loan is reasonable. We also find that it is reasonably likely the Company will be able to secure the financing from SunTrust, its existing lender. The proposed financing will lower the overall rate of return and income tax allowance, provide funds to repay the \$500,000 line of credit and enable DIUC to make additional improvements to pay down accounts payable.

However, we will not use the capital structures proposed by the Company, ORS, or that proposed by the Intervenor. Instead of using the debt to equity ratio from the Company's balance sheet, we will use a capital structure that equates to the \$6,958,724 rate base we are allowing in this case, assuming \$3,750,000 of debt and \$3,208,724 of equity, or a debt to equity ratio of 53.9% debt and 46.1% equity.

With respect to the cost of debt, we agree with the Company that the cost of undertaking financing is a reality that must be recognized. The Company did so by amortizing the cost over the life of the 15 year term loan, which is consistent with the NARUC USoA, Account 181, Unamortized Debt Discount and Expense, that provides for such expense to be amortized over the life of the respective issues under a plan which will distribute the amounts equitably over the life of the securities. *See* NARUC USoA, Account 181, Unamortized Debt Discount and Expense, paragraph c. The high cost of undertaking the Company's existing financing was unusual but an understandable and unavoidable effort under the circumstances experienced by this small utility as it sought to obtain funding that was essential to make improvements and to provide adequate service. *See* Transcript at 141-142.

We further find Mr. Guastella's testimony persuasive as to the cost of the loan, what he called the effective interest rate, particularly given Mr. Guastella's testimony that he has "never seen a utility's debt rate be based strictly on the nominal interest rate, because there's always a cost that is incurred in order to undertake financing." Transcript at 183. However, we will adjust the 6.2% "effective" interest rate sought by the Company. Mr. Guastella testified that he used the effective rate of the existing term loan because he did not yet know what the actual rate will be for the proposed financing, but he did not expect the cost of undertaking the refinancing to be as high. *See* Transcript at 253. For the purposes of this rate case, we find that several of the costs incurred in securing the first loan will not be incurred again in obtaining the second loan and it is reasonable to estimate a 5.75% effective interest rate.

The Company, ORS, and Intervenors all have a different approach for proposing an allowable return on equity. Addressing that issue requires consideration of the testimony of Mr. Guastella which highlights the unique circumstances facing DIUC.

Mr. Guastella identified the significant challenges that small utilities face in obtaining financing simply because of their size and sensitivity to earnings erosion that large utilities do not experience. *See* Transcript at 194. He quantified DIUC's significant loss over the last three years, despite the rate increase in August of 2012 that anticipated reasonable profits. *See* Transcript 193-194. Additionally, small utilities' stakeholders must also provide personal guarantees and stake personal assets as collateral in order to obtain financing as they have done here, which is something that is not required of large utilities in order to obtain financing. *See* Transcript at 185. He also described DIUC's three year process of securing financing, rejection by three banks, and the relatively massive documentation that was necessary to satisfy its lender. *See* Transcript at 184. Mr. Guastella testified that this reality of small utilities and of DIUC is not measured by typical

CEM, DCF and CAP-M methods using proxy groups of large utilities for data. *See* Transcript at 193.

ORS, via Dr. Carlisle, used comparison proxy groups including large utility companies for data. *See* Transcript at 473. Likewise, the Intervenor propose Mr. Lanier’s analysis of equity rates of return, which are also based on comparatives. *See Generally* Transcript at 436 to 441. We find that the utilities suggested as comparables by Dr. Carlisle and Mr. Lanier are not substantially similar and are not truly comparable to the Company.

The South Carolina Supreme Court has prohibited ratemaking decisions on such comparisons without substantiation. “We have held on several occasions that it is improper for the PSC to draw comparisons with other entities without stating its basis for finding the entities sufficiently similar for comparison purposes.” *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 114, 708 S.E.2d 755, 765 (2011) citing *Heater of Seabrook II*, 332 S.C. 20, 26, 503 S.E.2d 739, 742. In order to support the requested relief presumably evidenced by a comparison to other utility or utilities, the proponent of the same must provide the Commission with sufficient evidence in the record of the proposed comparison entities; without such evidence the comparison must be disregarded. *Id.*

The record in this case demonstrates a lack of information as to the utilities proposed for comparison by ORS and Intervenor. This Commission cannot assume the referenced utilities are similar, comparable, or sufficient to establish even the most basic of standards. On the other hand, Mr. Guastella’s testimony describes real differences in the ability of small utilities to attract capital as compared with large utilities. *See* Transcript at 185. His experience in both regulating and consulting for hundreds of small water and sewer utilities, as well as large utilities, allows him to

provide a realistic and valid analysis that supports DIUC's need for a higher return on equity than that of an average large utility.

Using a capital structure of 53.9% debt and 46.1% equity, an aggregate cost of debt rate of 5.75% per annum and the Company's proposed 10.5% return on equity, the result is an overall rate of return of 7.94%. That rate is less than DIUC's proposed 8.73% and higher than the overall 7.46% reflected in ORS's recommendation and the 7.28% reflected in Intervenor's recommendation, and properly addresses the irrefutable differences between DIUC and large utilities as to their ability to attract capital.

Accordingly, we find that an overall rate of return of 7.94% is reasonable. At this rate of return, DIUC's indicated operating margin is 16.1%, which we find is also reasonable. We further find this rate and operating margin are required to allow the Company to yield a reasonable return, as is required by law. *See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 107 n.8, 708 S.E.2d 755, 761 (2011) citing *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n of W. Va.*, 262 U.S. 679, 690, 43 S. Ct. 675, 67 L. Ed. 1176 (1923) (explaining that where the rates charged by a public utility company "are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service . . . their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment").

10. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 10

The evidence supporting this finding, that the Company is entitled to total rate case expenses of \$191,200, which is approximately one-half of the \$380,000 rate case expenses actually incurred in this rate case by DIUC as of October 28, 2015. And shall be amortized over a period of four years, ($\$191,200 / 4 \text{ years} = \$47,800 \text{ per year}$), is based upon the Application and testimony of witnesses Guastella, White, and Gearheart.

DIUC's application includes rate case expenses in the amount of \$191,200, estimated on the basis of its rate case expense requested in the last rate case. *See* Transcript at 218. The \$191,200 is allocated equally between water and sewer operations and amortized over a 4 year period. *See* Transcript at 218. The ORS proposes an amount for the instant rate case which it "capped" at \$75,000, plus unamortized rate case expenses of \$22,500 from the previous rate case, to be amortized over a 5 year period. However, ORS did not provide testimony to support its position.

A utility in a ratemaking proceeding is "entitled to a presumption that its expenditures were reasonable and incurred in good faith." *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 109, 708 S.E.2d 755, 762 (2011). "This presumption does not shift the burden of *persuasion* but shifts the burden of *production* on to the Commission or other contesting party to demonstrate a tenable basis for raising the specter of imprudence." *Id.* (Emphasis added.) Ms. Gearheart on behalf of ORS did not provide any analysis that establishes the basis for ORS's proposed \$75,000 cap on rate case expenses, and no testimony that the work included in the Company's proposed expense was not performed or not necessary. *See generally* Transcript at 484-500. This is insufficient to support the cap generally and in light of the presumed reasonableness of the expense. Even without the benefit of any presumption, in his rebuttal testimony Mr. Guastella outlined the extensive work involved in this proceeding and explained that the amount of information and paperwork required of DIUC was equal to that required of large utilities in rate cases. *See* Transcript at 181. In other words, the time, expense, and effort necessary

to pursue a rate application is not lessened because the utility has fewer customers of a smaller service area.⁶

Regarding amortization of expenses, Mr. Guastella testified that because the last DIUC rate case ended in mid-2012, only three years ago, that the Company's proposed 4 year amortization is more realistic than the 5 year amortization adjustment proposed by ORS. *See* Transcript at 218. At the hearing, Mr. Guastella also stated that in the last rate case the Company requested \$181,200 but that DIUC's actual expense totaled \$370,000; and in this case, the actual expenses are reported at \$380,000, yet DIUC is only requesting the Commission allow \$191,200. *See* Transcript at 181. DIUC's requested rate case expense of \$191,200 is similar in amount with the rate case expenses that we allowed in another 2012 contested rate decision.⁷ For these reasons, the requested total rate case expenses of \$191,200 will be allowed in this case and the same shall be amortized over a 4-year period, as proposed by the Company.

11. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 11

The evidence supporting this finding, that the actual and known and measurable amounts for Utility Property Taxes necessary to cover the eight year installment payments under DIUC's Settlement Agreement and Addendum with Beaufort County Treasurer and its ongoing annual amounts are \$65,855 and \$192,372, respectively, is based upon the Application and testimony of witnesses Guastella, White, Walls, Gearheart, and Loy. The property tax expense at issue in this matter has two components: the recovery of past due taxes in accordance with a settlement

⁶ The Commission notes that in this case, ORS required the Applicant to respond to 82 Continuing Information Requests and more than 40 individual Audit Requests.

⁷ In Docket No. 2011-317-WS, Order No. 2012-98, we allowed rate case expenses of \$190,905.

agreement between DIUC and Beaufort County Treasurer, and sufficient income to address current and future annual property taxes.

The record demonstrates that soon after the effective date of its last rate case, DIUC received a “Utility Property Tax” bill from Beaufort County for the years 2010, 2011, and 2012 at a combined total of some \$363,000, with 2012 at \$132,398. *See* Transcript at 50-51. This was the first time that SCDOR had ever assessed and Beaufort County had ever billed DIUC for a utility property tax. For this reason, Beaufort County billed DIUC for taxes in arrears even though the DIUC had not been billed in those prior tax years. DIUC had previously received property tax bills annually for individual parcels, totaling about \$10,000 annually, but neither DIUC nor its predecessors had ever received a Utility Property tax bill of such magnitude.

Testimony of Maria Walls indicated “that DOR did not identify Daufuskie Island Utility as a utility at all” and for that reason the Utility Property Tax had never been assessed to DIUC or its predecessors. Transcript at 78. At some point, it apparently came to the attention of the SCDOR that it had not assessed DIUC for Utility Property taxes, as it does for other utilities, and SCDOR sent its assessment to Beaufort County for the first time in mid-2012 for the years 2010, 2011, and 2012; Beaufort County then simply applied its tax rate and sent the bills to DIUC.

Mr. Guastella met with Maria Walls, Beaufort County’s Treasurer, to explain the rate setting process, DIUC’s cash flow problem, and the impact that this enormous tax liability that was recently imposed would have on the Company’s customers. *See* Guastella Rebuttal Exhibit B and Transcript at 82. As a result, on February 18, 2015, DIUC and Beaufort County entered into a Settlement Agreement that allows DIUC to pay past taxes for 2012, 2013, 2014 and 2015 over an eight year period without penalty or interest. *See* Walls Exhibit A. It also allowed for a

possible revision to reduce the total past amount due in the event DIUC could convince the SCDOR to reduce its assessment to reflect the value of the rate base allowed in DIUC's last rate case, instead of its book value (cost less depreciation). The Utility Property taxes for 2010 and 2011 were forgiven in this one-time special arrangement. *See* Transcript at 80 and 212.

Working next with SCDOR, the Company submitted revised documentation enabling the reduction of the Utility Property Tax assessment amount to reflect the last allowed rate base and agreed basis, which was set pursuant to a settlement agreement in that case. On April 28, 2015, DIUC and Beaufort County entered into a Settlement Agreement Addendum, reducing the past due Utility Property taxes by \$124,423.88 (from \$651,423.27 to \$526,843.39). The monthly payment was reduced from \$6,784.04 to \$5,487.95. *See* Walls Exhibit A Addendum. The Company began making the monthly payment on July 1, 2015, which equates to an annual amount of \$65,855.40, and it remains current on those payments. *See* Transcript at 83.

ORS proposes an annual amortization of \$30,612 related to the 8 year amortization of past taxes, which only allows payment of \$244,899 for the 2012 and 2013 portion of the total of \$526,843.39 due per the Settlement Agreement Addendum. Or, stated differently, the ORS adjustment excludes \$281,944 of currently owed taxes, even though the Company is contractually bound to make those payments. In testifying as to this issue, Ms. Gearheart provides no allowance for the portion of the 8 year payments related to 2014 and 2015 taxes that are part of the Settlement Agreement Addendum. The reason she provides for allowing only the past taxes for 2012 and 2013 is that, "In accordance with the settlement for the previous rate case Docket No. 2011-229-WS, the Company agreed not to file for an application for an increase before July 1, 2014." *See* Transcript at 495. We fail to understand how the negotiated rate application delay period in the

settlement of the last rate case is connected with the specific payment requirement in the Utility Property Tax Settlement Agreement Addendum.⁸ The \$65,856 annual payment is a known cost under a Settlement Agreement that reflects significant cost savings to DIUC and its customers from the total amount of past-due taxes the County originally billed DIUC, and it should be allowed for recovery in the rates.

With respect to the ongoing annual level of Utility Property Taxes, the Company requests \$192,372 for the combined water and sewer ongoing annual Utility Property Tax, which is calculated on the basis of its December 31, 2015, book value, application of DOR's method of assessment, and application of Beaufort County's current tax rate, which will be the basis for the 2016 Utility Property taxes. *See* Transcript at 168-170. ORS's proposed adjustment would allow only \$140,881, which is the total test year 2014 taxes based on a \$5,000,000 rate base. The 2014 taxes, however, are also being recovered over an 8 year period as part of the Settlement Agreement Addendum. The next annual Utility Property tax bill that DIUC will receive will be in the fall of 2016, payable in full on January 15, 2017. DIUC must collect funds now to pay that tax bill which will be higher than the amount in 2014. The rates resulting from this case will only become effective in early 2016. Thus, the allowance of ongoing annual taxes must be reflected in this revenue requirement for accrual during 2016 so that DIUC can make the January 2017 payment. Mr. Guastella's calculation⁹ of the annual tax amount of \$192,372, using the DOR assessment

⁸ Mr. Guastella also points out that if DIUC had been able to rush a rate increase in time to pay the 2014 and 2015 Utility Property taxes, the customers would have paid about \$280,000 over the subsequent two years; but by spreading the recovery over 8 years, the customers benefitted by present value savings of over \$100,000. *See* Transcript at 213.

⁹ There was an objection at the hearing that Mr. Guastella is not a DOR expert. As an expert in utility rate setting, Mr. Guastella's use of information obtained from third parties may certainly be accepted by this Commission.

methodology, is a reasonable estimate that qualifies as a known and measurable change, and will be allowed.

12. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 12

The evidence supporting this finding, that the management of DIUC's operation under the management agreement with Guastella Associates, LLC has been more than adequate, particularly given the challenges faced by the Company, and the management fees in the amount of \$171,364 are reasonable and may be recovered, based upon the Application and testimony of witnesses Guastella, Gearheart, and Lanier.

The management fees included in DIUC's application reflect charges under the agreement between Guastella Associates, LLC (GA) and DIUC and its owners. That agreement spells out GA's responsibilities and duties, and has provisions for fees and charges, including day-to-day management, finance, capital, and incentive fees. *See* Exhibit 9.

In the last rate case, ORS, Intervenors and the Company agreed via settlement that an acceptable allowance of 6.5% interest rate for a future loan later secured with SunTrust; this Commission approved that settlement. *See* Order No. 2012-515, Docket 211-229-WS. The finance fees charged by GA according to the management agreement for that loan, plus the legal fees incurred in obtaining the loan and applying to the Commission for approval of the financing, increased the "effective" interest rate on the SunTrust loan from 5.29% to 6.2%. *See* Transcript at 220-221. Even with the charges, this interest rate is still lower than the allowable 6.5% to which ORS and the Intervenors agreed. No party in this case has offered testimony that GA did not perform the work over the three-year period during which DIUC sought to obtain financing and no party has asserted that the work was not essential for improvements to the water and sewer systems or that the work was not necessary. As discussed above, the Commission will allow a

5.75% interest for the anticipated refinancing. That amount, again, is lower than the rate previously agreed to among the parties.

As with the finance fees, no party took the position that GA's work with respect to the capital fee was not performed or that it was unnecessary. Mr. Guastella testified that GA's charges for the administration and supervision of the capital improvements was less than half of such typical costs. *See* Transcript at 172 and 206. His testimony was unchallenged and unrefuted.

With respect to the incentive fee set forth in the management agreement, Mr. Guastella testified that the owners, not the customers, are responsible to pay that fee out of their equity.

We now turn to the day-to-day management fee, which DIUC proposes at \$171,364 in accordance with the management agreement. ORS proposes to reduce the management fee to \$132,211, a level that it claims the Commission previously approved.¹⁰ The only reason Ms. Gearheart provides in support of that reduction is that the management services provided by GA did not increase, stating "During the review, ORS did not find that the management services provided by Guastella and Associates ("GA") increased and did not find the requested increase justifiable." *See* Transcript at 493. ORS does not provide any other analysis, nor does ORS identify the services that were performed at the time of the last rate case or after the last rate case. In response to interrogatories, however, ORS acknowledges that the management services were performed by GA, they were necessary to provide service, and that GA was qualified to manage DIUC.

With respect to Ms. Gearheart's proposed adjustment to the GA management fee:

- a. Is it ORS's position that GA does not perform the services as set forth in its management agreement with DIUC?

¹⁰ The Commission approved a settlement in DIUC's last rate case that does not make any reference to the management fee.

RESPONSE: No.

- b. Is it ORS's position that the management services performed by GA are not necessary for the operation and management of DIUC?

RESPONSE: No.

- c. Is it ORS's position that GA is not qualified to perform the management services?

RESPONSE: No.

Response to Company's First Set of Interrogatories and Requests for Production to ORS at #8, Exhibit 10 to Transcript.

Intervenors do not propose a specific dollar adjustment for management fees, but Mr. Lanier does state that he "would support any reductions in expenses proposed by the ORS staff," without providing any rationale, standard, or benchmark for any such reduction. *See* Transcript at 435. Mr. Lanier also accuses the Company of not being operated in the most efficient and economical fashion, claiming it has had such "major lapses" in its operations as sale of the storage tank parcel, enormous increase in property taxes, DHEC issues, and control of operating expenses. *See* Transcript at 421. However, the record does not support a finding of a failure of management with respect to Mr. Lanier's claimed lapses. Mr. Guastella's testimony establishes that, as manager of the Company, GA acted in a reasonable, diligent, and timely manner to each of the items mentioned by Mr. Lanier.

Neither ORS nor Intervenors presented any performance analysis or review of the events and issues faced by DIUC since it was acquired from Haig Point, Inc. in 2008. The Company, on the other hand, provided the Commission with a comprehensive Report on Capital Improvements that includes information regarding the very unusual problems faced by the Company and how those problems were addressed by GA pursuant to its management agreement. *See* Exhibit 9. Of equal significance is the fact that neither ORS nor Intervenors performed any analysis to evaluate

whether the GA's management fees are competitive or whether DIUC could have obtained management with the same level of expertise as provided by GA at a lower cost. On the other hand, the record provides the following, as obtained from Mr. Guastella's testimony and exhibits, regarding the work of GA for DIUC:

- The hiring of GA was required in the settlement with an intervenor for the purchase of the stock of HPUC from Haig Point, Inc. to assure that DIUC would have competent management. *See* Transcript at 213.
- GA directed the transition for the HPUC acquisition as well as the merger of MUC, improving records, billing and operations. *See* Exhibit 7.
- GA managed the operations despite an immediate 25% annual shortfall of revenues because of MUC's failure to pay its share of the jointly owned wastewater treatment plant. *See* Exhibit 7.
- GA directed the operation of MUC, when its owners abandoned the utility operations and filed for bankruptcy in order protect the MUC's customers from interruption of water and sewer service, without compensation and despite DIUC's cash shortage. *See* Transcript at 214.
- GA undertook an extensive effort over about a three year period trying to obtain financing, including about 15 months after the 2012 rate increase, without which it would have been nearly impossible to continue to provide adequate service. GA's expertise in preparing qualified appraisals and rate setting were critical in obtaining approval of financing. *See* Transcript at 220.
- GA worked with the president of DIUC to use his contracting firm to make temporary repairs to the failed wastewater lagoon liner, when there were insufficient funds to pay for the improvements. *See* Exhibit 7.
- GA's expertise in appraisals, valuation and condemnations were beneficial in dealing with the condemnation of the land at the storage tank site. *See* Transcript at 220.
- GA saved DIUC and its customers over \$350,000 in property taxes and another \$100,000 in present value savings related to the 8 year payment agreement. *See* Transcript at 213 and Exhibit 7.
- GA's administration and supervision of the capital improvements saved DIUC and its customers as much as \$400,000 in construction costs, as well as

significant savings for the Fire Department for the construction of a helipad. *See Transcript at 173.*

- GA has been complimented by DHEC for its cooperation and efforts to make improvements, and its thorough communications with DHEC that are not typical. A corrective action plan prepared by GA was approved by DHEC within hours of submittal. *See Transcript at 215, and Exhibit 8.*
- GA's stated priority has been to provide adequate service to DIUC's customers. The owners have not been paid a dividend to date, and GA is owed thousands of accrued payments because cash flow is always first used to operate the water and sewer systems. Mr. Guastella noted that past due accounts payable to GA will eventually be paid by the owners not the customers. *See Transcript at 141 and 247.*

In accordance with the management agreement, GA's scope of services include:

1. Supervise the day to day operation and maintenance of the Company's system, including supervision of operating employees, vendors and contractors.
2. Maintain books and records, including accounting, financial and operation records, in accordance with the uniform system of accounts prescribed by the PSC and required by the DHEC.
3. Perform all billing, accounting and collecting (other than commencing litigation), including the preparation of customer account records and billing analyses as necessary for rate filing requirements.
4. Prepare financial and operating reports to regulatory agencies, including annual reports to the PSC and monthly operating reports to DHEC. Prepare annual budgets and financial reports to stockholders, as well as periodic (quarterly) financial and operating reports.
5. Provide information and assistance to outside tax accountants, consultants, engineers and attorneys as required in the normal course of business.
6. Obtain short and long term financing, as available and necessary, for operations and capital improvements and prepare the necessary documentation for lenders.
7. Employ and supervise all employees, vendors, contractors and outside professionals as appropriate to operate, maintain and expand the Company's system, to direct and supervise all plant expansion, capital improvements and replacements, and to carry out all other services required of GA under this Agreement.
8. Implement existing contracts with developers and customers, and negotiate and implement new contracts and applications for service.
9. Revise and maintain general tariff provisions as to rates and terms of service, in compliance with changes approved by the PSC.
10. Be responsible for and carry out all other business incidental to the ordinary course of business management and operation of the Company.

It is apparent that without the management agreement with GA, the Company would have to hire employees or another firm to perform these services, and it is not a given that such options would reflect the same qualifications and experience. While we are certainly aware of the customers' concerns about significant rate increases, it must also be noted in the context of management fees that there have been no customer complaints as to the water and sewer service provided by the Company.

With respect to the amount of GA's fees, Mr. Guastella provided a schedule comparing the costs per customer of DIUC with municipal water and sewer utilities in South Carolina. *See* Exhibit 8. After adjusting for taxes and cost of capital in order to compare the cost of operations on an equal basis, DIUC's cost per customer is lower than four of the eight utilities, even though the cost per customer should be considerably higher because DIUC has a much lower number of customers. Also, DIUC is on an island accessible only by boat. *See* Transcript at 216. One of the customers, Mr. James Woodward, testified at the public hearing on September 15, 2015 that:

"...Our members and our Haig Point residents already bear substantial costs for the pleasure, granted, of living on a private island. Building costs here, service costs, everything like that, you're just gonna' tack on 20 percent. I just got a quote recently from another company that said, Here's a quote that I normally do this job for, but on Daufuskie Island we triple it.'..."

Mr. Guastella's testimony and exhibits as to GA's qualifications and performance in managing DIUC and the competitive level of its fees and charges are persuasive. We find no basis for reducing the Company's proposed management fees.

13 – 16. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 13 – 16

The evidence supporting these findings, as more fully stated above, is based upon the Application and testimony of witnesses Guastella, White, and Gearheart.

The Application before us seeks a 108.9% rate increase on a combined basis for its water

and sewer operations, or a revenue increase of \$1,182,301. On the basis of our findings as discussed above, we have prepared the attached schedules containing operating statements for DIUC's combined water and sewer operations, along with separate schedules for water and sewer. These schedules reflect the Company's pro forma operations under its proposed rates and the operations that reflect the Commission's findings in this Order. The approved rate increase is 94.6%, on a combined basis for its water and sewer operations. *See* Application Schedule A.

A review of the evidence presented indicates the appropriate operating expenses for DIUC for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable changes total \$1,537,203. Applying the fair and reasonable rate of return established in Finding #9, a 7.94% rate of return on rate base, the total operating revenue requirement for DIUC is \$2,089,652. *See* Application Schedule A.

In order for DIUC to have the opportunity to earn its total operating revenue requirement of \$2,089,652, DIUC must be allowed additional revenues totaling \$1,016,071. *See* Application Schedule A. Although DIUC requested a higher increase, the Commission finds this additional revenue amount is sufficient and reasonable based upon the testimony presented by all parties to this proceeding.

Under the guidelines applicable to this Commission and articulated in the decisions of *Bluefield Waterworks and Improvement Company v. West Virginia Pub. Serv. Comm'n*, 262 U.S. 679 (1923), and *Federal Power Commission v. Hope Natural Gas*, 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce specific net revenues. However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility and ... that are adequate under efficient and

economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield, supra*, at 692-693.

The rates as contained in Schedule A to this Order and explained herein are hereby approved and effective for service rendered on or after the date of this Order. We find that the rates and charges approved herein achieve a balance between the interests of the Company and those of its customers. These rates and charges result in a reasonable attainment of the Commission ratemaking objectives in light of applicable statutory safeguards.

17. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 17

The evidence supporting these findings, as to establishing a single tariff rate structure, is based upon the Application and testimony of witnesses Guastella, White, Gearheart, Morgan, and Lanier.

DIUC's application proposes to establish a single tariff rate structure, instead of its existing rate structure that has different rates for the Haig Point and Melrose service areas. See Application at Schedules W-E2 and S-E2. No party has objected to this revision. The Company's water and sewer systems are sufficiently integrated as to operations, management, billing, financing, and regulations to justify the use of a single tariff pricing. The tariff rates set forth in Schedule A reflect single tariff pricing and rates that will generate the allowed revenue requirement as approved in this Order. Therefore the Company's request for a single tariff rate structure is approved and established as set forth in Schedule A.

18. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 18

A compromise and settlement is an agreement between adverse parties that resolves the proceeding between them. *W. T. Ferguson Lumber Co. v. Elliott*, 171 S.C. 455, 459, 172 S.E. 616, 617, 1934 S.C. LEXIS 20, *8 (S.C. 1933) ("... an action will be held to be ended when the parties

agree upon a compromise and settlement of the cause of action and the terms of the agreement are complied with.”) “It is said of compromise and settlement agreements in 15 Am. Jur. (2d) 951, that "the mutual concessions which constitute a compromise generally involve the performance or promise (express or implied) of (1) the relinquishment of a claim by one party in return for the relinquishment of a claim by the other party; or (2) the relinquishment of a claim by one party in return for a payment or transfer of property by the other party; or (3) a payment or transfer of property by one party in return for a payment or transfer of property by the other party -- accompanied by at least an implied relinquishment of one or more claims." *Brazell Bros. Contractors v. Hill*, 245 S.C. 69, 75, 138 S.E.2d 835, 838, 1964 S.C. LEXIS 38, *8-9 (S.C. 1964)

Here neither ORS nor the Intervenors were the applicant nor did ORS have a claim against the Intervenors or vice versa. Both Intervenors and ORS are adverse to the Company, not to each other. While each took separate positions in relation to the application of the Company, there can be no resolution of the rate proceeding without the agreement of the Company. Neither ORS nor the Intervenors has the authority to compromise and settle the lawful right of the Company to seek an adjustment of its rates and charges.

Further, to the extent that ORS and the Intervenors purport in their agreement to stipulate to certain findings, this agreement is not a binding stipulation in this proceeding as to the Commission or the Company as a matter of law. A binding stipulation requires the written concurrence of all the parties to the proceedings. *See*, Rule 39 (a), SCRCP (a binding stipulation is one that is entered by all the parties and entered on the record). Here, DIUC was not a party to the purported agreement and stipulation.

Moreover, both Intervenor and ORS proceeded on the merits and presented testimony in addition to the prefiled testimony of their respective witnesses. The testimony of the Intervenor's witnesses contradicted the terms of the "settlement agreement" and the testimony of the ORS witnesses. There would have been no need for either Intervenor or ORS to proceed with proof of any kind, much less offering evidence in addition to their respective prefiled testimony, if the matter had been resolved.

For these reasons, the Commission puts no evidentiary weight on the proposed "settlement agreement," which is also hearsay, and receives it basically as a brief or other filing asserting a position statement of Intervenor and ORS as to the outcome that they are advancing rather than as evidence. As stated previously, since the Company was not a party to the agreement and the agreement did not settle any matters before this Commission without the concurrence of the Company, the Commission does not approve the "settlement agreement" as a settlement of this rate application.

As indicated throughout this Order, the Commission has decided the matter based on the testimony and other exhibits entered into the record and the applicable law. A ratemaking proceeding is quasi-judicial proceeding and, as such, the Commission determines admissibility of evidence as well as what weight should be given to testimony and exhibits. *See* 26 S.C. Code Ann. Regs. 103-846(A) ("The rules of evidence as applied in civil cases in the Court of Common Pleas shall be followed" in ratemaking proceedings); Rule 402, SCRE ("All relevant evidence is admissible, except as otherwise provided by the Constitution of the United States, the Constitution of the State of South Carolina, statutes, these rules, or other rules promulgated by the Supreme Court of South Carolina.").

The purported “settlement agreement” is not compelling proof of any issue in this proceeding, and by law the Commission considers only “reliable, probative, and substantial evidence.” S.C. Code 58-5-240.

The willingness of two parties, to the exclusion of the Company, to agree upon a position does not make that position more correct or more reliable. Further, this Commission must be wary not to open the door to the use of partial settlement agreements that do not include the applicant as a means for adverse parties to consolidate their position in hopes of directing proceedings which they themselves did not initiate. ORS and Intervenors ask this Commission to embark on a new trend which the Commission is not willing to embrace.

V. CONCLUSION

As set forth above, this Commission has, in compliance with S.C. Code §58-5-240, determined a fair rate of return for the Company and has documented fully the reasons for its determination in its Findings of Fact which are based exclusively on reliable, probative, and substantial evidence on the whole record.

IS THEREFORE ORDERED THAT:

1. The proposed schedule of rates and charges as filed in the Company's Application is found to be reasonable, as modified herein, and is granted.
2. The schedule of rates and charges attached hereto as Appendix A is hereby approved for service rendered on or after the date of this Order. The schedule is deemed filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240.
3. The Company shall maintain its books and records in accordance with the NARUC Uniform System of Accounts as adopted by this Commission.

4. The Company shall notify each customer in each class of the customers' increase in rates with the first bill that includes the new increase in rates made subject to this Order.

BY ORDER OF THE COMMISSION:

Nikiya Hall, Chairman

ATTEST:

Swain E. Whitfield, Vice-Chairman